Nos. 88-1130, 88-1136

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In the Supreme Court of the United States

October Term, 1988

NUTRI/SYSTEM, INC., HAROLD KATZ, MARTIN S. BEGUN, THOMAS W. L. CAMERON, A. DONALD McCULLOCH, JR., ALBERT J. DiMARCO, REEF C. IVEY, II AND JOHN E. SYLVESTER,

Petitioners,

v.

HENRY HERSKOWITZ, ALAN ROSMAN, JOSEPH FABIAN, NISSIM HUSNI, DONALD SUNSHINE and JACK POTOK and FRED POTOK, JOINT TENANTS, on behalf of themselves and all others similarly situated,

Respondents.

(No. 88-1130)

and

CONNECTICUT NATIONAL BANK,

Petitioner,

v.

HENRY HERSKOWITZ, et al.,

Respondents.

(No. 88-1136)

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED FOR REVIEW

1. In a case involving a materially false and misleading proxy statement, was it incorrect for the Court of Appeals to overturn a directed verdict and remand for jury trial where substantial evidence was presented that a statement of opinion included in the proxy statement lacked a reasonable basis?

2. Should an exception be created to the negligence standard of liability applied under section 14(a) of the Securities Exchange Act of 1934 for an investment banker who publishes a false and misleading statement in the proxy?

3. Where petitioners never properly raised the issue before the Court of Appeals and where the issue is not ripe for review, should this Court hold that federal courts are bound by a single factor—the market price of securities—in determining damages in federal securities cases?

4. Where petitioners never properly raised the issue before the Court of Appeals and where the issue is not ripe for review, should this Court hold that minority shareholders are not entitled to the protection against false and misleading proxy statements provided by the federal securities laws when one shareholder controls enough shares to determine the outcome of a proxy vote?

5. Where the Court of Appeals did not rule on the issue, should this Court hold that the existence of a cause of action under state law means that there can be no cause of action under section 10(b) and section 14(a) of the Securities Exchange Act of 1934 for a false or misleading proxy statement?

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ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF RESPONDENTS IN OPPOSITION

STATEMENT OF THE CASE

These class actions, consolidated for trial and on appeal, arose from the issuance of what plaintiffs contend was a

materially false and misleading proxy statement in violation of sections 10(b) and 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78(j)(b) and §78(n)(a) and Rules 10b-5 and 14a-9 promulgated thereunder by the Securities and Exchange Commission ("SEC"). The proxy statement was issued in connection with a merger of Nutri/System, Inc., a Pennsylvania corporation, with a newly formed corporation controlled by a group of the company's senior management as part of the management group's leveraged buy-out of the company for $7.16 a share. Plaintiffs claimed that the proxy statement disseminated by the company to solicit shareholder approval for the merger violated the federal securities laws. In addition, plaintiffs asserted a pendent claim that the terms of the merger were unfair in violation of Pennsylvania law.

These cases were tried before a jury in November 1987. At trial plaintiffs introduced evidence concerning the serious misrepresentations and omissions in the proxy statement.[1]

1. These misrepresentations and omissions included:

(1) That the five year income projections published in the proxy statement were significantly below the projections that the management group actually believed would be most likely to be achieved, which higher figures were given to potential private investors and included in the company's internal operating budget.

(2) That certain sections of the proxy statement painted an overly gloomy picture of the company's future prospects while, at the same time, the management group was touting the success of its turnaround plan to potential private investors.

(3) That a "fairness opinion" rendered by defendant Connecticut National Bank and published in the proxy statement stating that the merger consideration was "fair from a financial point of view" was materially false or misleading because it lacked a reasonable basis in that CNB made a number of incorrect assumptions in valuing the Company.

(4) That the proxy statement falsely stated that a portion of CNB's fee was conditional upon its fairness opinion being published, whereas, that portion was, in fact, contingent on the transaction being completed.

(5) That the proxy statement incorrectly portrayed the negotiations leading to the leveraged buy-out as arm's length, whereas, in fact, the timing and terms of the transaction were dictated by the Chairman and founder of the company who owned 56% of the company's outstanding stock.

Plaintiffs also introduced evidence that the terms of the merger were unfair, in violation of state law.

The District Court refused to allow the jury to consider evidence, *inter alia*, that the proxy statement was materially false and misleading because statements and opinions therein made by Nutri/System and Connecticut National Bank ("CNB"), which was the investment advisor in connection with the merger and which published a fairness opinion in the proxy statement, had no reasonable basis, and entered a directed verdict on that issue. The District Court submitted the remainder of the case to the jury on special interrogatories. The jury returned a verdict for the defendants and judgment was entered on the verdict. Plaintiffs appealed the judgment to the Court of Appeals for the Third Circuit, raising numerous claims of error. CNB filed a cross-appeal concerning the District Court's refusal to instruct the jury that a finding of *scienter* was required to hold an investment banker rendering a fairness opinion liable under section 14(a).

The Court of Appeals reversed the judgment of the District Court on two grounds and sent the case back for a new trial. First, it held that the District Court improperly removed from the jury's determination a factual issue as to which there was a genuine dispute—*viz.* whether the proxy statement was false and misleading because the CNB fairness opinion was based, *inter alia*, on the erroneous assumption of a 46% corporate tax rate over the next five years and, therefore, lacked a reasonable basis.[2] Second, it held that the District Court misconstrued plaintiffs' pendent state law claim when it instructed the jury, *inter alia*, that it was, essentially, the same as plaintiffs' federal securities laws claims. *See Herskowitz v. Nutri/System, Inc.*, 857 F.2d 179 (3d Cir. 1988).

The Court of Appeals also considered and rejected CNB's cross-appeal, holding that the District Court correctly instructed the jury as to the standard of liability under section

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2. The Court of Appeals recognized that plaintiffs submitted substantial evidence on this issue. *See Herskowitz v. Nutri/System, Inc.*, 857 F.2d 179, 184-185 (3d Cir. 1988).

14(a) and Rule 14a-9 for an investment banker that renders a fairness opinion to be published in a proxy statement. The Court of Appeals considered it appropriate, because it was remanding the cases for a new trial, to decide this question, even though the jury never reached the issue of which of the defendants were liable under section 14(a) and Rule 14a-9. 857 F.2d at 189.

SUMMARY OF THE ARGUMENT

There is no need to grant certiorari to decide any of the issues raised by petitioners. The Court of Appeals reversed the judgment of the District Court principally on the ground that the District Court erred in not letting the jury decide whether a proxy statement containing an investment banker's "fairness opinion" was false or misleading when there was sufficient evidence for the jury to have decided that one of the principal assumptions on which the opinion was based was objectively unreasonable. This holding involved a straightforward application of the "reasonable basis" standard for opinions articulated by the Third Circuit in *Eisenberg v. Gagnon*, 706 F.2d 770, 776 (3d Cir.), *cert. denied*, 474 U.S. 946 (1985). This standard is the same as, or consistent with, the standard for determining the falsity of statements of opinion under the federal securities laws applied in all circuits that have ruled on the issue.

The issue of the standard of liability to be applied to investment bankers under Section 14(a) of the Exchange Act, while decided by the Court of Appeals, is not ripe for review because the jury never reached the issue of which defendants were liable and may never reach the issue when the case is retried. Moreover, the decisions of the various circuits are not in conflict on this issue. The Court of Appeals' conclusion that a negligence standard should be applied follows previous precedent from the Third Circuit and other Courts of Appeals and is the conclusion mandated by previous decisions of this Court analyzing the language of the federal securities laws.

The other issues raised by Nutri/System were not addressed by the Court of Appeals and had no bearing on its decision. Therefore they should not be reviewed by this Court. The issue whether the market price of securities establishes their value for purposes of determining damages to remedy violations of the federal securities laws was not preserved in the Court of Appeals. It is essentially an evidentiary issue that is not of importance to the operation of securities markets or the administration of the federal securities laws, and there is no conflict among the various circuits regarding this issue. Moreover, all of the economic evidence on the record in this case, including Nutri/System's experts, supports the view that Nutri/System's value was in excess of its market price.

The issue whether minority shareholders may seek redress for a false or misleading proxy statement when one shareholder controls enough shares to determine the outcome of the proxy contest was not preserved for review by this Court. It is not necessary for this Court to rule on this issue because past decisions of this Court, beginning with *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616. 54 L.Ed.2d 278 (1970), have held that proof of materiality of a misstatement or omission in a proxy statement eliminates the need to establish a causal connection between the misstatement or omission and the outcome of the vote.

The issue whether a private right of action for dissemination of a false or misleading proxy statement may be implied under Sections 10(b) and 14(a) of the Exchange Act when an appraisal remedy for "fair value" is provided by state law was settled by this Court in *J.I. Case Co. v. Borak*, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964) and reaffirmed in *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616, 54 L.Ed.2d 279 (1970). Therefore, there is no need for this Court to grant certiorari to decide this issue in this case.

REASONS FOR NOT GRANTING THE WRIT

The Court of Appeals' principal holding in this case was that there was substantial evidence as to whether or not the

Nutri/System proxy statement was false or misleading because certain statements therein lacked a reasonable basis and that a jury should have been allowed to consider the issue. The Court of Appeals correctly applied the standard for reviewing a directed verdict pronounced by this Court—that the evidence must be viewed in the light most favorable to the party against which the directed verdict is granted, giving it "the benefit of all inferences which the evidence fairly supports, even though contrary inferences might reasonably be drawn." *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 696, 82 S.Ct. 1404, 1409, 8 L.Ed.2d 777 (1962). Accordingly, the Court held that the District Court should not have granted a directed verdict on the issue. In so holding the Court of Appeals applied a generally accepted standard for determining liability under the federal securities laws for projections and other statements of opinion.

This is a straightforward case brought pursuant to the Securities Exchange Act of 1934 alleging the issuance of a false and misleading proxy statement. Neither the case nor the Court of Appeals' decision raised or decided any new or controversial issue. Yet petitioners[3] seek a writ of certiorari presenting five separate issues for review. Not one involves a conflict among the circuits; not one involves a deviation by the Court of Appeals from any decision of this Court; and not one raises a new or important issue which has not been, but should be, settled by this Court. Supreme Court Rule 17.1. In addition, three of the five issues were never even considered, discussed, or decided by the Court of Appeals. Finally, not one issue is ripe for review. The Court of Appeals has made no finding or determination of law or fact which it has applied to these petitioners. All it has done is to hold that the District

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3. Petitioners in No. 88-1130 are defendants Nutri/System, Inc., Harold Katz, Martin S. Begun, Thomas W. L. Cameron, A. Donald McCullough, Jr., Albert J. DiMarco, Reef C. Ivey, II and John E. Sylvester (referred to collectively herein as "Nutri/System"). They raise the issues discussed in Sections I, III, IV and V, *infra*. Petitioner in No. 88-1136 is defendant Connecticut National Bank ("CNB"). It raises the issues discussed in Sections I and II, *infra*.

Court erred in granting a directed verdict to defendants and that, under the particular facts that were developed in the case and at trial, a jury should be allowed to consider plaintiffs' claim that the Nutri/System proxy statement was false and misleading. Petitioners have not even attempted to argue that the Court of Appeals incorrectly applied the standards relating to a directed verdict or that there was no substantial evidence submitted which would support plaintiffs' claim.

There is no reason for this Court to grant a writ of certiorari.

I. The Standard Applied By The Court of Appeals In Reversing The District Court's Grant of A Directed Verdict As To The Issue Of Whether Statements In The Proxy Lacked A Reasonable Basis Is Consistent With Third Circuit Precedent And The Law Of Every Other Circuit That Has Considered The Issue

Both petitioners seek review of the Court of Appeals' holding that the District Court erred in refusing to allow the jury to consider whether the proxy statement was materially false or misleading because a key basis underlying the statements set forth in the CNB fairness opinion was objectively unreasonable. They urge the Court to grant certiorari to "annunciate clearly the standard for misstatements of opinions and projections made in connection with securities transactions." CNB Petition at 15; *see also* Nutri/System Petition at 11.

In reaching its conclusion that the District Court improperly removed a question of fact from the jury's consideration, the Court of Appeals applied the standard for determining when projections or other expressions of opinion are actionable that it had articulated in *Eisenberg v. Gagnon*, 766 F.2d 770 (3d Cir.), *cert. denied*, 474 U.S. 946 (1985):

> In *Eisenberg v. Gagnon* we held that projections are actionable if "issued without a genuine belief or rea-

> sonable basis," 766 F.2d at 776, thus articulating both a subjective ("without genuine belief") and an objective (without "reasonable basis") test. . . . [T]he more reasonable interpretation of the rule is that it permits recovery when an expert, in making a projection, adopts an assumption which the factfinder concludes was objectively unreasonable in the circumstances."

Herskowitz, 857 F.2d at 185.

Petitioners concede that the *Eisenberg* standard is not inconsistent with the standard applied in other circuits for determining liability for projections or statements of opinion.[4] And neither petitioner suggests that the *Eisenberg* standard is incorrect or should not have been applied by the District Court in this case. Rather, CNB argues that the Court of Appeals "misapplied" the *Eisenberg* standard to the facts in this case, and Nutri/System argues that, notwithstanding the Court of Appeals statement that it was "[a]pplying the *Eisenberg* test to the evidence . . .", the Court of Appeals in fact applied a different, improper standard, which is at odds with the analysis applied by other circuit courts. But, because the decision of the Court of Appeals in fact involved the straightforward application of a universally accepted standard, certiorari should not be granted.

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4. *See* CNB Petition at 16 ("Courts from other circuits have articulated standards for judging false opinions or projections consistent with that set forth in *Eisenberg*"); Nutri/System Petition at 11 (characterizing standards of other circuits as "similar [but] not identical" to the *Eisenberg* standard). Petitioners are correct. Every circuit court which has considered the issue agrees with the Third Circuit. *See Isquith v. Middle South Utilities*, 847 F.2d 186, 204 (5th Cir.), *cert. denied*, 109 S.Ct. 310 (1988) (falsity of a prediction is determined by whether the prediction "suggested reliability, bespoke caution, was made in good faith or had a sound factual or historial basis"); *Luce v. Edelstein*, 802 F.2d 49, 56 (2d Cir. 1986); *Polin v. Conductron Corp.*, 552 F.2d 797, 806 n. 28 (8th Cir.), *cert. denied*, 434 U.S. 857 (1977); *Gottreich v. San Francisco Investment Corp.*, 552 F.2d 866, 867 (9th Cir. 1977); *Marx v. Computer Science Corp.*, 507 F.2d 485 (9th Cir. 1974); *S.E.C. v. Okin*, 137 F.2d 862, 864 (2d Cir. 1943).

The petitioners argue at cross-purposes. CNB argues that the Court of Appeals did not but should have applied the *Eisenberg* "reasonable basis" test to the "projection" by CNB of a 46% tax rate, instead of to CNB's fairness opinion. CNB Petition at 17. But the fact that CNB assumed a 46% tax rate in its valuation was not stated in the proxy statement. Neither this Court nor any other federal court has held that an internal, unpublished projection *alone* can be the basis of liability under the federal securities laws. Therefore, the Court of Appeals was correct in applying the *Eisenberg* "reasonable basis" test to the *published* fairness opinion and analyzing whether the use of the 46% tax rate as a basis for that published opinion was objectively reasonable.

Nutri/System, on the other hand, argues that the Court of Appeals erred by doing exactly what CNB said it should have done but did not do—*viz.*, apply the *Eisenberg* "reasonable basis" test to the projections underlying the published fairness opinion instead of to the fairness opinion itself. *See* Nutri/System Petition at 12. In fact, the Court of Appeals correctly applied the "reasonable basis" test to the fairness opinion which was published in the proxy statement:

> Applying the *Eisenberg* test to the evidence . . . , we hold that it is sufficient to present a jury question as to *whether it was reasonable for Connecticut National Bank to render a fairness opinion in July 1986 based on a cash flow projection which assumed a 46% tax rate for the next five years.*"

Herskowitz, 857 F.2d at 185. (emphasis added).

Nutri/System's argument that this Court should grant certiorari because the standard applied by the Court of Appeals in this case permits a finding of liability "regardless of the truth or falsity of the statement made and regardless of full disclosure," Nutri/System Petition at 12, is simply incorrect. The Court did no such thing. In fact, it found no liability at all. All the Court of Appeals held is that the evidence presented a jury question regarding whether CNB's published opinion that the $7.16 per share consideration being paid to

Nutri/System's shareholders was "fair" to minority shareholder lacked a reasonable basis because of the use by CNB of a particular undisclosed assumption in reaching its conclusion. The Court of Appeals' holding in this case is, therefore, completely consistent with *Eisenberg* and the decisions of other courts that have addressed the issue.

Both CNB and Nutri/System argue that this Court should "clarify" how the Third Circuit's "reasonable basis" standard should be applied. A fair reading of the majority opinion of the Court of Appeals in this case compels the conclusion that the Third Circuit's "reasonable basis" standard, as articulated in *Eisenberg* and applied in this case, is quite clear and poses no problem in application. To the extent the standard should require "clarification," which respondents submit it does not, that "clarification" should come from the Third Circuit and does not require this Court to grant certiorari.

Moreover, the interpretation of the "reasonable basis" standard urged by petitioners has not been adopted by any circuit and should not be endorsed by this Court. Petitioners' interpretation would allow a person rendering an opinion in a publicly disseminated document to escape liability if, *post hoc*, he were able to articulate *any* rational reason for coming to the conclusion expressed, no matter how unreasonable or irrational other assumptions upon which the opinion was based were, and no matter how improbable or misleading the opinion was at the time it was made when viewed objectively in light of all the facts then known. Such a standard would afford no protection at all to investors who rely upon the opinions of experts such as investment bankers in reaching their investment decisions and would make a mockery of the disclosure requirements of the securities laws whose purpose is "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business entities in the securities industry." *Securities and Exchange Commission v. Capital Gains Research Bureau*, 375 U.S. 180, 186, 84 S.Ct. 275, 280, 11 L.Ed.2d 237 (1963).

II. The Issue Of The Standard Of Liability To Be Applied To Investment Bankers Under Section 14(a) Is Not Ripe For Review And Involves No Conflict Among The Circuits; The Circuit Court's Standard Follows This Court's Rulings

The Court below, following its holding in *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761 (3d Cir. 1976), held that *scienter* was not required for liability to attach to an investment advisor for that advisor's false statements contained in a proxy. This Court should not grant a writ of certiorari to consider this issue.

A. The Issue Is Not Ripe

Plaintiffs asserted claims against CNB under sections 10(b) and 14(a) of the Exchange Act, 15 U.S.C. §78(j)(b) and §78(n)(a), arising out of CNB's false statements published in the proxy statement. The District Court refused CNB's request for an instruction to the effect that *scienter* was required to find an investment banker rendering a fairness opinion intended for publication in proxy statement liable under section 14(a), but did instruct the jury that it could not find CNB liable under section 10(b) unless it found that CNB in fact acted with *scienter*. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). After the District Court removed from the jury the tax rate evidentiary issue discussed in point I, *supra*, and granted a directed verdict against plaintiffs, the jury found that the fairness opinion was not false and misleading. Hence, the jury never reached the question whether CNB acted with *scienter* or only negligently.

Despite the fact that CNB won a verdict in the trial court and that the jury never determined whether or not it acted with *scienter*, CNB cross-appealed the District Court's failure to give its requested instruction regarding the standard of liability under section 14(a). Plaintiffs filed a motion to dismiss the cross-appeal on the ground that CNB could not

appeal from a judgment entered on a verdict entirely in its favor. However, the Court of Appeals decided to entertain the cross-appeal and held that the District Court was correct in refusing to instruct the jury that *scienter* was necessary for CNB to be liable under section 14(a).

In seeking a determination of the standard of liability applying to investment bankers under section 14(a), CNB requests this Court to review an issue that had no bearing on the judgment entered in the District Court or on the Court of Appeals' reversal of that judgment. The Court of Appeals rendered what is, in effect, an advisory opinion on the issue. This Court should not involve itself by granting certiorari to review that advisory opinion.

This issue is clearly not ripe for decision. Since plaintiffs' claims against CNB include section 10(b) as well as section 14(a), plaintiffs will, regardless of whether *scienter* is required under section 14(a) against CNB, in fact present at trial evidence demonstrating CNB's *scienter*. Thus the only thing that would occur if certiorari were granted would be a delay of the trial of this case. A decision by this Court on the proper standard will have no effect on the trial itself—plaintiffs will still present exactly the same evidence and defendants will still present exactly the same defense. In addition, this issue may never be ripe for decision. If, for example, the jury finds that the fairness opinion did not lack a reasonable basis it will not reach the issue on remand. Or, if in connection with plaintiffs' section 10(b) claims, the jury finds that CNB acted with *scienter*, the issue will be moot. Therefore, review by this Court of this issue is plainly inappropriate at this time and certiorari should not be granted.

B. There Is No Conflict Among The Circuits And The Standard Applied By The Appeals Court Comports With This Court's Decisions

Certiorari should not be granted also because application of any standard other than negligence in actions under section 14(a) would depart from well settled principles for deter-

mining standards of liability under the federal securities laws established by prior decisions of this Court and other lower courts.

This Court has instructed that determining the standard of liability for a particular section of the federal securities laws requires "ascertainment of congressional intent," which determination "rest[s] primarily on the language of that section." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200, 96 S.Ct. 1375, 1384, 47 L.Ed.2d 668 (1976). In *Hochfelder* the Court found that the language of section 10(b) of the Exchange Act, which makes unlawful the use or employment of "any *manipulative* or *deceptive device* or *contrivance*," evidenced a congressional intent to limit liability under section 10(b) to cases where *scienter* was present. *Id.*, 425 U.S. at 197, 96 S.Ct. at 1383. In applying the same analysis to the express language of section 14(a) and concluding that section 14(a) required only proof of negligence, the Second Circuit observed that section 14(a) "contain no such evil-sounding language." *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1299 (2d Cir. 1973). Instead, section 14(a) merely prescribes "a type of disclosure or lack of it, i.e., false or misleading statements or omissions of material facts." *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 777 (3d Cir. 1976). As the Third Circuit concluded in *Gould* in holding an outside director liable for his negligent failure to verify the accuracy of a proxy statement: "The language of section 14(a) and Rule 14a-9(a) contains no suggestion of a *scienter* requirement, merely establishing a quality standard for proxy material." *Id.*

The differences in functions and scope of section 14(a) and section 10(b) also compel the conclusion that the *scienter* standard adopted in section 10(b) actions is not appropriate for actions under section 14(a). Unlike section 10(b) and Rule 10b-5, which apply to any and all statements issued by corporations even when they are under no obligation to disseminate information, section 14(a) and Rule 14a-9 apply only to specific types of *required* disclosures in connection with certain types of transactions or corporate actions, i.e., those requiring the vote of shareholders. Courts have viewed this distinction

as imposing a higher duty of care under section 14(a) for proxy solicitation materials than under section 10(b). *Gerstle*, 478 F.2d at 1300; *see Gould*, 535 F.2d at 777, (analogizing section 14(a) to section 11 of the Securities Act of 1933, which imposes a negligence standard for false or misleading registration statements).

This analysis has been widely accepted by federal courts, which have consistently held that negligence governs liability in section 14(a) actions.[5] In fact, no case of which respondents are aware, whether district court or circuit court, has ever held that a *scienter* standard should be applied to a section 14(a) claim against an investment advisor for statements made by that investment advisor in a proxy statement.

The Securities and Exchange Commission has also taken the position that negligence is the proper standard of liability to be applied under section 14(a). *See Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 623 F.2d 422, 446-47, *cert. denied*, 449 U.S. 1067 (1980) (opinion dissenting from order denying *en banc* consideration quoting from memorandum of SEC as *amicus curiae*). As the administrative agency charged by Congress with the responsibility for interpreting and enforcing the federal securities laws, the SEC's view is entitled to substantial weight. *Andrus v. Shell Oil Co.*, 446 U.S. 657,

5. *See, e.g., Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 777 (3d Cir. 1976); *Gruss v. Curtis Publishing Co.*, 534 F.2d 1396, 1403 (2d Cir.) *cert. denied*, 429 U.S. 887 (1976); *Wilson v. Great American Industries, Inc.*, 661 F.Supp. 1555, 1574 (N.D.N.Y. 1987); *Management Assistance, Inc. v. Edleman*, 584 F.Supp. 1021, 1028 (S.D.N.Y. 1984); *Plant Industries v. Bregman* 490 F.Supp. 265, 269 n.16 (S.D.N.Y. 1980); *Fradkin v. Ernst*, 571 F.Supp. 829, 842 (N.D. Ohio 1983); *Bertoglio v. Texas International Co.*, 488 F.Supp. 630, 652 (D. Del. 1980); *Securities and Exchange Commission v. Wills*, 472 F.Supp. 1250, 1268 (D.D.C. 1978); *Roberts v. Magnetic Metals Co.*, 463 F.Supp. 934, 941 (D.N.J. 1970), *rev'd on other grounds*, 611 F.2d 450 (3d Cir. 1979); *Berman v. Thomson*, 403 F.Supp. 695, 699 (N.D. Ill. 1975); *Norte & Co. v. Huffines*, 304 F.Supp. 1096, 1109-1110 (S.D.N.Y. 1968) aff'd in pertinent part, 416 F.2d 1189 (2d Cir. 1969), *cert. denied*, 397 U.S. 989 (1970); *Richland v. Crandall*, 262 F.Supp. 538, 553 (S.D.N.Y. 1967); *Billet v. Storage Technology Corp.*, 72 F.R.D. 583, 585 (S.D.N.Y. 1976); *see also Shidler v. All American Life & Financial Corp.*, 775 F.2d 917, 926 (8th Cir. 1985).

100 S.Ct. 1932, 1943, 64 L.Ed.2d 593 (1980) (dissenting op.); *United States v. National Association of Securities Dealers*, 422 U.S. 694, 719, 95 S.Ct. 2427, 2442, 45 L.Ed.2d 486 (1975).

The Sixth Circuit's decision in *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, *cert. denied*, 449 U.S. 1067 (1980) does not conflict with this general view. In *Adams*, the Sixth Circuit held that a *scienter* standard should be used to determine the liability of a public accounting firm for misstatements in the footnotes of certified annual financial statements included in a proxy statement. The holding of *Adams* is expressly limited to accountants who prepare financial statements included in proxy statements, 623 F.2d at 428. An important consideration in the Sixth Circuit's application of a *scienter* standard under those circumstances was the fact that the certification of the financial statements by the accountants in *Adams* was not prepared in connection with the proxy statement. It was simply prepared by the accountants as part of their general auditing function and was included later in the proxy statement to solicit shareholder approval of a particular act of the board of directors.[6] So the court rejected an attempt to expose an accountant to potential negligence liability as a result of a use of his opinion that was not contemplated at the time the opinion was rendered.[7]

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6. For example, in *Adams* the financial statements at issue were dated as of August 2, 1969 and the accountants' opinion certifying them was dated October 21, 1969. These financial statements were subsequently published in the proxy statement, which was dated March 27, 1970. 623 F.2d at 425-26.

7. *Adams* has been strictly limited to its facts even by courts within the Sixth Circuit. *See Fradkin v. Ernst*, 571 F.Supp. 829, 842 (N.D. Ohio 1983) (limiting *Adams* to accountants and holding corporate issuer liable under a negligence standard); *S.E.C. v. Youmans*, 543 F.Supp. 1292, 1302 (E.D. Tenn. 1982), *rev'd on other grounds*, 729 F.2d 413 (6th Cir. 1984) (stating that it is "unclear whether scienter is always required" to constitute a violation of section 14(a)). The only case other than *Adams* of which respondents are aware to ever apply a *scienter* standard in a section 14(a) action is *Zatkin v. Primuth*, 551 F.Supp. 39 (S.D. Cal. 1982), which, relying on *Adams* imposed a *scienter* standard on accountants who audited financial statements subsequently included in a proxy statement.

In contrast to the accounting firm in *Adams*, which performed periodic audits and, on that basis, certified the corporation's annual financial statements, the corporation's directors in *Gould*, were direct participants in approving the merger transaction and in disseminating the proxy statements. As explained by the Third Circuit, the outside director held to have violated section 14(a) "was responsible with his fellow directors for the actions of the board in which he participated as well as for his own acts or failures to act. *Gould*, 535 F.2d at 776.

CNB concedes in its petition for certiorari that there is no genuine conflict among the courts of appeals that have considered the issue of the standard of liability under section 14(a), and it argues that the Third Circuit's previous decision addressing the issue, *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761 (3d Cir. 1976), can be reconciled with the Sixth Circuit's decision in *Adams*. CNB Petition at 10-11. Respondents agree that there is no genuine conflict and that the Third Circuit's analysis in *Gould* can be harmonized with that of the Sixth Circuit in *Adams*. Moreover, the Third Circuit's decision in the instant case not only follows *Gould*, but is also not in conflict with *Adams*.

In the instant case, CNB was engaged by the two non-management, outside directors of Nutri/System, who were designated as a "special committee" and charged with the responsibility of making a recommendation to Nutri/System's minority shareholders regarding management's proposed leveraged buy-out. To discharge this responsibility the Nutri/System outside directors engaged CNB to provide a fairness opinion, which CNB knew would be and was in fact published in its entirety in the proxy statement. CNB was paid a substantial fee for its services in connection with the leveraged buyout. CNB was, in effect, a paid surrogate for the outside directors. Under these circumstances there is no principled way in which the conduct of CNB in rendering its fairness opinion could be evaluated by a different standard than that of the outside directors. Thus, the Court of Appeals was correct in affirming the District Court's decision not to depart from *Gould* in this case. Since CNB has taken the position that

Gould is neither inconsistent with *Adams* nor incorrectly decided, a position with which respondents concur, and in view of the overwhelming weight of authority holding that negligence is the correct standard to be applied in section 14(a) actions and the fact that the Court of Appeals correctly applied that standard, there is no need for certiorari to be granted to review this issue.

III. The Issue Of How To Value Publicly Traded Securities Is Not Ripe For Review, Involves No Conflict Among The Circuits And Is Not An Issue Of Importance To Federal Law

Nutri/System seeks review of this case for the purpose of determining whether the market price of a publicly traded security is "presumptively conclusive" of its value in connection with a merger. Nutri/System Petition at 6. Nutri/System has not stated any valid reason for certiorari to be granted on this issue, and it should not be granted.

A. The Issue Of Whether The Market Price Is "Presumptively Conclusive" Of Value Was Not Preserved For Review

The stock price issue was not raised by Nutri/System in its brief or argument in the Court of Appeals and, therefore, may not be considered on writ of certiorari. *G.D. Searle & Co. v. Cohn*, 455 U.S. 404, 412 n.7, 102 S.Ct. 1137, 1143 n.7, 71 L.Ed.2d 250 (1982); *Delta Air Lines, Inc. v. August*, 450 U.S. 346, 362, 101 S.Ct. 1146, 1155, 67 L.Ed.2d 287 (1981).[8] In

8. Nutri/System acknowledges it never raised this issue in its briefing on the merits in the Court of Appeals, but asserts that it "preserved" this issue in the Court of Appeals by raising it in its Petition for Rehearing. Nutri/System Petition at 5-6 n.6. The Court of Appeals voted not to hear the Petition for Rehearing without requesting a response from plaintiffs. Under these circumstances there is no basis to conclude that the Court of Appeals ever considered the merits of any of Nutri/System's arguments made therein. In *Hoover v. Ronwin*, 466 U.S. 558, 574 n.25, 104 S.Ct. 1989, 1998 n.25, 80 L.Ed.2d 590 (1984), this Court held that raising an issue for the first time in a response to a petition for rehearing was insufficient to preserve the issue for review by this Court. *A fortiori*, raising an issue for the first time in the Court of Appeals in a petition for rehearing where no response is requested fails to preserve the issue.

addition, where the Court of Appeals has not decided an issue, it is not appropriate for review by writ of certiorari. *United States v. Frady*, 456 U.S. 152, 158 n.7, 102 S.Ct. 1584, 1589-90 n.7, 71 L.Ed.2d 816 (1982). In this case the Court of Appeals did not consider the stock price issue, nor was there any reason for it to do so even if Nutri/System had raised it. At trial, the jury having been erroneously instructed by the trial judge, found in favor of defendants on plaintiffs' claims of nondisclosures and omissions in the proxy statement. Hence, the jury never reached the issue of damages and had no occasion to address the issue of the value of company. Because the issue of valuation had nothing to do with the jury's verdict, there was no valuation issue for the Court of Appeals to review. Likewise, no such issue is ripe for review by this Court.

B. There Is No Need To Grant Certiorari To Review The Market Price Issue Raised By Nutri/System

1. There is No Conflict Among The Circuits And No Important Question of Federal Law is Presented

Nutri/System has not suggested that there is any conflict in the decisions of the various circuits on the issue of valuation in mergers where minority stockholders are eliminated, but only that "[t]he Courts of Appeal have given different levels of legal significance to the price at which a stock actively trades." Nutri/System Petition at 6. The issue that Nutri/System seeks this Court to determine is essentially an evidentiary issue that has no bearing on the activities of national securities markets or administration of the federal securities laws.

Moreover, issues relating to the fair value of securities are fundamentally the concern of state, not federal law. *See Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 478, 97 S.Ct. 1292, 1303, 51 L.Ed.2d 480 (1977). Therefore, there is no important question of federal law for this Court to settle.

2. Nutri/System's Argument Conflicts With The Decisions of This Court and Other Federal Courts and is Contrary to Economic Reality

This Court has spoken clearly on the broad range of remedies available under section 14(a), stating that federal courts must "provide such remedies as necessary to make effective the congressional purpose [of the statute]" and "adjust their remedies so as to grant the necessary relief." *J.I. Case Co. v. Borak*, 377 U.S. 426, 433, 84 S.Ct. 1555, 1560, 12 L.Ed.2d 423 (1964).

The decisions of this Court, as well as those of numerous lower courts have established that federal courts are not limited by the pre-merger market value of a corporation's securities in fashioning remedies for violations of section 14(a) and Rule 14a-9 in connection with corporate mergers. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972); *Randall v. Loftsgaarden*, 478 U.S. 647, 106 U.S. 3143, 3153, 92 L.Ed.2d 525 (1986); *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 782 (3d Cir. 1976); *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1304 (2d Cir. 1973); *see Plaine v. McCabe*, 797 F.2d 713, 721-22 (9th Cir. 1986).

Nutri/System asks this Court to establish a rule on a complex, theoretical economic issue. Such a rule should only be considered in a case with a well developed factual record, including extensive expert testimony supporting its adoption. This would be an inappropriate case to consider Nutri/System's argument since all of the economic evidence in the record, both by plaintiffs' expert and Nutri/System's experts, was that the value of the company was well in excess of the market price.[9]

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9. Plaintiffs' expert and CNB, Nutri/System's board of director's financial advisors who were designated by Nutri/System at trial as its valuation experts, agreed that the proper method for valuing the company was through a discounted cash flow analysis based upon the company's projected future cash flows.

IV. The Question Whether Section 14(a) Was Intended To Protect Minority Shareholders When One Shareholder Can Control The Outcome Of A Proxy Vote Was Not Preserved In The Court Of Appeals And Has Been Settled By This Court and Other Courts Of Appeals

Nutri/System seeks review of this case to determine whether minority shareholders are entitled to the protection provided in section 14(a) against false and misleading proxy statements where one shareholder controls enough shares to determine the outcome of a proxy vote.

This issue also was not preserved in the Court of Appeals,[10] nor was the issue addressed by the Court of Appeals in reaching its decision. Therefore, it is not subject to review by writ of certiorari.

Nutri/System seeks a ruling that minority shareholders in this case cannot recover for defendants' false and misleading proxy statement because of the absence of a causal relationship between the false and misleading proxy statement and the ultimate outcome of the proxy vote. Such a ruling would be squarely contrary to the holding of *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616, 54 L.Ed.2d 279 (1970), where this Court rejected such a causation requirement. The Court held, instead, that proof of materiality was sufficient and that "there is no need to supplement this [materiality] requirement with a requirement of proof of whether the defect *actually had a decisive effect on the voting*." 396 U.S. at 384-85, 90 S.Ct. at 622. (emphasis added). *See also TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 444, 96 S.Ct. 2126, 2130, 48 L.Ed.2d 757 (1976); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 63-64, 95 S.Ct. 2069, 2078, 45 L.Ed.2d 12 (1975); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 383 (3d Cir. 1974); *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1301 (2d Cir. 1973); *Popkin v. Bishop*, 464 F.2d 714, 718 (2d Cir. 1972).

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10. Nutri/System concedes that this issue was not raised in the Court of Appeals except in its Petition for Rehearing, which is insufficient to preserve the issue. *See* note 8, *supra*.

Nutri/System has offered no reason for overruling a past precedent of this Court which has become one of the cornerstones of federal securities law jurisprudence. Therefore, certiorari should not be granted to determine this issue.

In addition, plaintiffs' claims are also asserted under section 10(b) to which Nutri/System's argument would have absolutely no bearing, and thus this case would proceed regardless of this Court's ruling on this issue.

V. The Question Whether A Private Right Of Action Exists Under Sections 10(b) and 14(a) Of The Exchange Act For A False And Misleading Proxy Statement Has Long Been Settled By This Court, And The Necessity Of Protecting The Federal Interest In Full And Fair Disclosure Is Not Diminished By The Existence Of State Appraisal Rights

Nutri/System also seeks review to determine whether a private right of action for damages exists under section 14(a) and section 10(b) for a false and misleading proxy statement where state law may also provide a cause of action. Since this issue was not addressed by the Court of Appeals, certiorari should not be granted to decide it. *United States v. Frady*, 456 U.S. 152, 155, n.7, 102 S.Ct. 1584, 1589-90 n.7, 71 L.Ed.2d 816 (1982).

In addition, this issue was settled by this Court twenty-five years ago in its unanimous decision in *J.I. Case Co. v. Borak*, 377 U.S. 426, 433-34 84, S.Ct. 1555, 1560-61, 12 L.Ed.2d 423 (1964). There the Court held unequivocally that private litigants may maintain suits for damages to redress violations of section 14(a) regardless of whatever rights they may also have under state law.[11] In *Mills v. Electric Auto-Lite*

11. Numerous decisions have recognized the availability of a private right of action under section 10(b) for false or misleading statements in documents such as proxy statements. *See, e.g., Wright v. Heizer Corp.*, 560 F.2d 236, 250 (7th Cir. 1977); *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255 (3d Cir. 1972); *Hahn v. Breed*, 587 F.Supp. 1369 (S.D.N.Y. 1984); *S.E.C. v. Youmans*, 543 F.Supp. 1292 (E.D. Tenn. 1982), *rev'd on other grounds*, 729 F.2d 413 (6th Cir. 1984); *Issen v. GSC Enterprises, Inc.*, 522 F.Supp. 390 (N.D. Ill, 1981).

Co., 396 U.S. 375, 381-82, 90 S.Ct. 616, 620, 54 L.Ed.2d 279 (1970), this Court again expressly rejected the argument that the existence of state appraisal remedies relating to the terms of a merger precluded a private right of action under section 14(a) observing that, if the rule were otherwise, "[t]he result would be to insulate from private redress an entire category of proxy violations—those relating to matters other than the terms of the merger." *See also, TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 444, 96 U.S. 2126, 2130, 48 L.Ed.2d 757 (1976). No case has held or ever suggested the contrary.

Santa Fe Industries v. Green, 430 U.S. 462 (1977), relied on by Nutri/System, fully supports a private right of action in this case. *Santa Fe* held only that in order to state a claim under section 10(b), a complaint must allege material misrepresentations or omissions. As acknowledged by Nutri/System in its Petition[12] the issue presented to the jury in connection with plaintiffs' section 10(b) and section 14(a) claims involved alleged material misrepresentations or omissions in defendants' proxy statement. The only issues of "fair value" in this case arose in connection with plaintiffs' pendent state claim, which was not presented to the jury independently from the federal nondisclosure claims and plaintiffs' damage claims, which the jury did not reach.

This case is a paradigm federal securities case alleging serious violations of section 14(a) and 10(b) for misstating and omitting to state material facts in a proxy statement. Accordingly, a federal cause of action is properly stated and certiorari should not be granted to decide this issue.

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12. See Nutri/System Petition at 4 n.4.

CONCLUSION

For all of the reasons stated herein, respondents respectfully request that the petitions for writ of certiorari be denied.

Respectfully submitted,

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